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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
Review of the Commission's Regulations Governing Television Broadcasting	)	MM Docket No. 91-221
Television Satellite Stations Review of Policy and Rules	)	MM Docket No. 87-8

To: The Commission

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PETITION FOR RECONSIDERATION OF PEGASUS COMMUNICATIONS CORPORATION

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Pegasus Communications Corporation ("Pegasus"), by its undersigned attorneys, hereby submits its Petition for Reconsideration of the Report & Order ("Local Ownership R&O") issued in the above-referenced proceeding. As demonstrated more fully below, Pegasus submits, inter alia, that the Commission's new duopoly rule will not survive judicial review because it completely ignores the unrefuted evidence in the record that LMAs and/or duopolies improve programming and viewpoint diversity in smaller markets by enabling new station start-ups or upgrades that were otherwise not economically possible. Instead, the Commission's wooden insistence on an 8 independent voices test illogically and irrationally allows duopolies and LMAs only in larger markets -- markets where they are economically least required. Ironically, this approach will undermine the Commission's own stated interests in programming and viewpoint diversity because it ignores the underlying economic entry barriers that have previously stymied new, over-the-air station entry in smaller markets. To correct this fatal flaw, the Commission should presumptively allow the formation and subsequent transfer of any television duopoly in smaller markets that adds a new television station to the market or that rescues a station from bankruptcy.[1]

I. INTRODUCTION & SUMMARY.

Pegasus is the ultimate owner of UHF television stations in a number of small markets, ranging from Scranton/Wilkes Barre, Pennsylvania (DMA No. 49), Portland/Auburn, Maine (DMA No. 80), to Tallahassee, Florida (DMA No. 114). In order to achieve the economies of scale necessary to compete in these smaller markets, markets that have high cable penetration and are typically dominated by 1 or 2 well-established VHF stations, Pegasus has aggressively pursued LMAs, several of which were entered into after November 5, 1996. These LMAs, which fully complied with the Commission's LMA policies and guidelines, have substantially enhanced over-the-air programming diversity in these markets by permitting start-ups of new television stations -- start-ups that would not have occurred without the infusion of financial and operational assistance from Pegasus. These new stations have signed on in recent years as affiliates of one of the new national networks, creating new outlets in markets that had previously been inaccessible and providing exciting new programming to viewers.

[1] To the extent deemed necessary by the Commission, Pegasus hereby requests a waiver of Section 1.429's page limits on certain petitions for reconsideration. See 47 C.F.R. § 1.429(d). Pegasus submits that such a waiver is in the public interest because the instant Petition addresses a number of important constitutional and statutory construction issues raised in the Local Ownership R&O and related docket, which spanned nearly 9 years and involved numerous parties and thousands of pages of comments.

In extensive comments filed earlier in this proceeding, Pegasus demonstrated that a combination of economic factors have created substantial entry barriers to new station start-ups in its markets. These entry barriers, which include the high fixed costs of station construction, limited overall market revenues and competition from both entrenched, typically VHF over-the-air stations and cable systems offering dozens of channels, have combined to stifle new station start-up. Because these factors inhibit both competition and programming diversity in these markets, Pegasus urged the Commission to abandon the simplistic notion that duopolies in smaller markets presented the greatest risk to the public interest. In fact, Pegasus and others demonstrated that precisely the opposite was true -- namely that these economic barriers made the liberalization of the duopoly rule in these small markets vital to any meaningful hope that diversity and competition would be enhanced.

Despite this substantial and unrefuted evidence, the Commission took a "one size fits all" approach in its Local Ownership R&O by requiring that a market have 8 independent television voices before the Commission would permit duopolies in the ordinary course. The Commission clearly recognized that this standard effectively precludes duopolies in smaller markets but remarkably noted that "it is in these small markets that consolidation of broadcast television ownership could most undermine our competition and diversity goals" -- an observation that completely ignored the substantial evidence that those goals had already been undermined by the economic factors discussed above. Local Ownership R&O, ¶ 70. In an apparent attempt to reconcile this decision with the record, the Commission created 3 waiver tests for failed, failing and new stations ostensibly designed to "provide relief in a more tailored fashion" in smaller markets -- waiver standards that must be satisfied both upon the creation of a duopoly and then again in a subsequent sale of the combined stations.

Pegasus has filed its Petition for Reconsideration to help the Commission adapt its new duopoly rule to serve rather than undermine its competition and diversity goals in smaller markets. First, under the 1996 Telecommunications Act and general principles of administrative law, Pegasus argues that the Commission cannot limit grandfathering relief to those LMAs entered into before November 5, 1996 because the effect of this decision impermissibly applies the Commission's recently enacted attribution decision and duopoly rule retroactively. Second, Pegasus demonstrates that the Commission's rote focus on ownership diversity in the form of the 8 independently owned station duopoly rule will not survive judicial review because it will inhibit rather than enhance diversity in smaller markets. Pegasus illustrates that the Commission's stubborn insistence on 8 independently owned stations ignores the economic realities in small markets and ironically will guarantee that 8 stations will NEVER be established in those markets. Finally, Pegasus demonstrates that the waiver criteria, which must satisfied at both inception and transfer, do not adequately address these problems because they create too much uncertainty and will, accordingly, not provide sufficient incentive to make the significant investment and commitment needed to compete in these smaller markets.

To correct these flaws, Pegasus urges the Commission to adopt a presumptive duopoly rule for smaller markets that allows both the formation and subsequent sale of any duopoly whenever a new, separately programmed television station is added to the market or a station is rescued from bankruptcy. Pegasus believes that any concerns about undue market power at the time of a duopoly transfer will be addressed by the standard antitrust review performed by either the Department of Justice or Federal Trade Commission. To the extent the Commission is unwilling to rely on this antitrust review, Pegasus reiterates its previous suggestion that the Commission limit the transfer of any duopoly whenever the combined share of the stations involved exceeds either 40% or the market share of the top ranked station in the market, whichever is smaller. Duopolies failing this presumptive test would be subject to further review. This proposed small market duopoly rule will actually enhance both the Commission's competition and diversity goals by recognizing and counteracting the economic entry barriers that have combined to stifle new station start-up in these markets. Without such a change, viewers in these small markets should expect nothing more than the status quo as the economics in these markets are guaranteed to prevent the creation of 8 television voices, independent or not.

II. THE TELECOMMUNICATIONS ACT OF 1996 PREVENTS THE COMMISSION FROM LIMITING GRANDFATHERING RELIEF TO TELEVISION LMAS ENTERED INTO BEFORE NOVEMBER 5, 1996.

The Commission's decision in the Local Television R&O to limit grandfathering relief to Television LMAs entered into before November 5, 1996 is directly contrary to the mandate of Section 202(g) of the Telecommunications Act of 1996 ("1996 Act") and is thus prohibited by the Supreme Court's decision in Chevron and its progeny. Section 202(g) provides that "[n]othing in this section shall be construed to prohibit the origination, continuation, or renewal of any television local marketing agreement that is in compliance with the regulations of the Commission." Because television LMAs entered into after November 5, 1996 did not violate the Commission's rules, and indeed will not violate the Commission's rules until the new local television ownership and attribution rules take effect, the Commission is expressly prohibited from limiting their "origination, continuation, or renewal."

Chevron USA, Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984) governs judicial review of an agency's interpretation of a statute it has been charged with administering. Under the first step of the analysis, a reviewing court must determine whether Congress has spoken directly on the issue in question. A court will employ the traditional tools of statutory construction in an attempt to unearth the plain meaning of the statute, analyzing the text, the statute's structure and context, and its legislative history. See, e.g. Florida Public Telecommunications Association Inc. v. FCC, 54 F.3d 857 (D.C. Cir. 1995). If Congress has expressed its clear intention with respect to the issue, then both the court and the agency are obligated to apply the meaning Congress intended.

Here, the plain meaning of the statute and the relationship between the statute and the Commission's earlier proposal to attribute television LMAs and provide limited grandfathering relief demonstrate that Congress intended to limit the Commission's ability to alter the treatment of LMAs to prospective changes only. As noted above, Section 202(g) provides that "[n]othing in this section shall be construed to prohibit the origination, continuation, or renewal of any television local marketing agreement that is in compliance with the regulations of the Commission." The use of the word "shall" is indicative of Congress' intent to limit the Commission's authority with respect to existing television LMAs. "Shall" has been interpreted by the D.C. Circuit as "the language of command," signifying that the requirement set forth is mandatory. See Southwestern Bell Corporation v. FCC, 43 F.3d 1515, 1521 (D.C. Cir. 1995). Had Congress wanted to grant interpretive leeway to the FCC, permitting it to decide which LMAs would be protected and which would not, Congress could easily have remained silent on the issue. See Illinois Bell Telephone Company v. FCC, 966 F.2d 1478,1483 (D.C. Cir. 1992).

The meaning of Section 202(g) is also informed by the Commission's efforts to attribute LMAs in this very proceeding, a proceeding which was ongoing when Congress enacted the 1996 Act. In early 1995, the Commission's Further Notice of Proposed Rulemaking in this proceeding proposed to attribute television LMAs to the station providing programming and proposed to grandfather any LMA entered into prior to the adoption date of the Further Notice. Review of the Commission's Regulations Governing Television Broadcasting, Further Notice of Proposed Rulemaking, ("Television Further Notice") 10 FCC Rcd. 3524 ¶ 138 (1995). In adopting this proposal, the Commission noted that "[i]f the local TV multiple ownership rules are not relaxed, such an attribution provision would preclude TV LMAs in any market where the time broker owns or has an attributable interest in another TV station." Id.

Given this backdrop, Pegasus submits that Congress's intention with regard to LMAs in the 1996 Act is crystal clear. Section 202(c)(2) directed the Commission to complete this very proceeding ("conduct a rulemaking proceeding concerning the retention, modification, or elimination of the duopoly rule") while not mandating a specific outcome. However, in light of the distinct possibility -- publicly recognized by the Commission itself in 1995 -- that the Commission's duopoly rulemaking could result in the prohibition of previously permitted LMAs, Congress prohibited the Commission from interfering with "the origination, continuation, or renewal" of any television LMA that was in compliance with the regulations of the FCC at the time it was created.

The legislative history of the Telecommunications Act confirms this interpretation. The Joint Explanatory Statement of the Conference Committee states that "[s]ubsection (g) [of section 202] grandfathers LMAs currently in existence upon enactment of this legislation and allows LMAs in the future, consistent with the Commission's rules." Thus, the plain intent of Congress, as expressed in the referenced report, is to preclude Commission interference with LMAs as long as those LMAs complied with FCC regulations at the time they were created. While the Commission is not precluded from changing its rules applicable to LMAs, it is prohibited from applying those changes retroactively. See Southwestern Bell Corporation v. FCC, 43 F.3d 1515

(D.C. Cir. 1995) ("the FCC cannot abandon the legislative scheme because it thinks it has a better idea").

That the Commission has taken until 1999 to change its rules regarding the treatment of television LMAs does not alter this analysis. If, as several Commissioners suggested in their concurring statements, there is a concern that some LMAs were somehow abusive or otherwise violated the Commission's existing rules and policies applicable to LMAs (e.g., because they involved a premature transfer of control), the Commission is free under the 1996 Act to deny grandfathering relief to these LMAs because they were not in compliance with the Commission's rules at the time they were entered into. What the Commission cannot do under the 1996 Act, however, is reach back generically to November 5, 1996 (a date that has no particular significance) with its rule changes based on unspecified concerns about unidentified abuses. Accordingly, the Commission must identify those LMAs that did not comply with its rules and grandfather all other television LMAs until such time as its new duopoly and attribution rules become effective.

III. THE COMMISSION LACKS THE AUTHORITY TO LIMIT GRANDFATHERING RELIEF TO PRE-NOVEMBER 5, 1996 LMAs UNDER THE ADMINISTRATIVE PROCEDURES ACT.

The Commission's decision to limit grandfathering relief to LMAs entered into before November 5, 1996 also violates general principles of administrative law because it effectively, and impermissibly, applies both its decision to attribute LMAs to the brokering station and its new duopoly rule retroactively. As noted above, LMAs entered into after November 5, 1996 were and will continue to be permissible under the FCC's ownership rules until the recently announced changes become effective in mid-November 1999. The effect of this limitation on grandfathering relief is to apply the Commission's 1999 rulemaking decisions, including both the decision to attribute LMAs and its new duopoly waiver standards, to relationships entered into as far back as two years ago. This the Commission cannot do.

It is axiomatic that agency rules developed according to the rulemaking procedures of the Administrative Procedure Act ("APA") are to be prospective in application only. See Georgetown University Hospital v. Bowen, 821 F.3d 750 (D.C. Cir. 1972).[2] Retroactive application of such rules is foreclosed by the express language of the APA. The statute defines a rule as "an agency statement of general or particular applicability and **future** effect." 5 U.S.C. § 551 (1995) (emphasis added). Furthermore, section 553(d) of the APA provides that a rule must be published no later than 30 days prior to its effective date, thereby prohibiting a rule from retroactive effectiveness. If Congress has not conferred retroactive rulemaking power on an agency through express language in the agency's statute, no such power exists. See Motion Picture Association of America v. Oman, 969 F.2d 1154, 1155 (D.C. Cir. 1992). A court will not read a statute to confer such extraordinary power unless it was the clear intent of Congress to do so. See Georgetown, 821 F.2d at 758.

The Commission fails to identify any specific provision of the Telecommunications Act that explicitly authorizes the power to promulgate retroactive rules. As noted above, section 202(g) provides that "nothing in this section shall be construed to prohibit the origination, continuation, or renewal of any television LMA that is in compliance with the regulations of the FCC." Far from authorizing retroactive rulemaking authority, see Bowen v. Georgetown

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[2] The decision of the D.C. Circuit in this case was affirmed by a unanimous Supreme Court in Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988).

University Hospital, 488 U.S. 204, 208 (1988), section 202(g) is evidence that Congress explicitly intended to limit the FCC's power regarding LMAs to prospective action only. Similarly, in section 202(c)(2), Congress instructs the Commission to conduct a rulemaking regarding the retention, modification, or elimination of the duopoly rule. Once again, nothing in this language authorizes the FCC to apply its rules retroactively. Absent statutory language to the contrary, prospectivity is the appropriate default rule. See Landgraf v. USI Film Products, 511 U.S. 244, 272 (1994). The failure to provide explicitly for retroactive application means that regulatory power does not exist.

The Commission's actions here with regard to television LMAs entered into after November 5, 1996 clearly have retroactive effect. In order for these previously (and currently) lawful relationships to remain in effect, the parties will of necessity be required to comply with the Commission's 1999 duopoly rule and related waiver standard -- a result that clearly requires the retroactive application of these recent decisions. The Supreme Court has delineated a three prong test to determine whether a rule has a retroactive effect: whether it would impair rights possessed by a party when that party acted, whether it would increase a party's liability for past conduct, or whether it would impose new duties on a party with respect to transactions already completed. See Landgraf, 511 U.S. at 280; see also DIRECTV, Inc. v. FCC, 110 F.3d 816, 825-6 (D.C. Cir. 1997). The Commission's rule impairs the rights of Pegasus and others who entered into LMAs on or after November 5, 1996, increases Pegasus' liability for these past decisions, and imposes "new duties" in connection with these LMAs. Therefore, the Commission's decision has impermissible retroactive effects.

Both before and after November 5, 1996, Pegasus and other television licensees were clearly not precluded by the Commission's rules from entering into television LMAs. Indeed, the

Commission's rules were so permissive regarding television LMAs that it was forced to issue a public notice nearly one year later requesting basic additional information about the number, nature and underlying factual circumstances of television LMAs in the industry. Pegasus entered into its post-November 5, 1996 LMAs in reliance upon existing FCC attribution and ownership rules and made substantial investments as a direct result of this reliance. The Commission acknowledges the need to avoid disruption of LMAs entered into "in good faith reliance" on the rules as they existed prior to November 5, 1996. See Local Ownership R&O ¶ 59. However, it fails to acknowledge that the same rules could be and were reasonably relied upon by parties entering into subsequent LMAs.

Instead, the Commission believes that the Second Further NPRM in this proceeding provided notice to the parties of the Commission's intent to attribute LMAs.[3] There are several problems with this reasoning. First, this pronouncement came in a Second Further Notice of Proposed Rulemaking. Obviously, a proposed rule is not effective until adopted. Second, even if "notice" of the possibility that a rule might be changed in the future somehow cures this fatal, procedural defect, the Commission fails to recognize that the impact of its announcement on attributing LMAs depended crucially on the extent of the other changes it was considering to the duopoly rule. The supposedly "clear" notice about attribution of LMAs was muddled by the Commission's other proposals on duopoly relief.

These duopoly proposals included a proposed rule explicitly permitting UHF-UHF combinations and proposed permanent waiver standards for failed stations, vacant and new

[3] See Review of the Commission's Regulations Governing Television Broadcasting, Second Further Notice of Proposed Rulemaking, MM Docket No. 91-221, FCC 96-438, released November 7, 1996 ("Second Further Notice").

allocations in small markets, as well waivers where the applicant demonstrated public interest programming benefits would result from the combination. Second Further Notice ¶¶ 33, 42-46, 54-55. Thus, the effect of attribution notice was ambiguous for Pegasus because each of its post November 5, 1996 LMAs involved only non-dominant UHF stations, each of which resulted in the construction of previously unbuilt stations and produced demonstrable public interest programming benefits in its markets -- benefits that would not have been achieved but for the combined operations of the stations. Accordingly, Pegasus had numerous reasons to believe that its LMAs would satisfy the proposed new duopoly rule, thereby rendering the decision to attribute LMAs irrelevant.

A similar "notice" argument made by the Secretary of Health and Human Services was rejected by the D.C. Circuit in Georgetown University Hospital v. Bowen, 821 F.2d 750, 756 (D.C. Cir. 1987). There, the Secretary adopted a rule in 1981 regulating reimbursement for wage expenses under the Medicare Act. That rule was invalidated by a district court, as it was authorized without the notice and comment procedures required by the APA. Three years later, the Secretary promulgated an identical rule, this time following the procedures required by the APA, and attempted to make the rule retroactive to 1981. The D.C. Circuit rejected the Secretary's argument that the 1981 rulemaking attempt served as notice to the parties that the agency intended to change its policy, finding "that this proffered exception to the requirement that legislative rules be prospective in effect only is completely at odds with basic tenets of administrative law." Id. at 757. Similarly, the Commission cannot use Second Further NPRM as the basis to apply its new LMA attribution and duopoly rules retroactively. At most, the Second Further NPRM can only represent an indication of the Commission's desire to address the question of LMAs and duopolies, with an outcome to be determined after the completion of the standard notice and comment period.

Because the Commission's grandfathering decision increases the liability of Pegasus and others for their economic investments that were in full compliance with the rules when made and imposes new duties on these parties, the Commission is precluded from limiting grandfathering relief to pre-November 5, 1996 LMAs. Not only will Pegasus suffer serious economic harm if it is forced to undo its LMAs; the viewers in its markets will also lose the acknowledged public interest benefits of these LMAs. These benefits, which the Commission recognized included significant operating efficiencies that contribute to improved programming as well as to ensuring the continued survival of a struggling station, are as significant for LMAs entered into after November 5, 1996 as for LMAs entered into prior to that date. Local Television R&O ¶¶ 34-36, 57. Because the Commission did not, and indeed could not, identify any authority for retroactively applying its LMA attribution and duopoly rules, it cannot limit grandfathering relief to LMAs entered into before November 5, 1996. Failure to address this problem by the Commission gives rise to significant federal constitutional due process concerns.

IV. THE COMMISSION'S DIVERSITY JUSTIFICATION FOR THE REVISED TELEVISION OWNERSHIP RULES FAILS CONSTITUTIONAL SCRUTINY.

In the Report & Order, the Commission justifies its intrusive broadcast regulations -- including its stringent ownership restrictions -- by asserting that these rules promote the diversity of viewpoints broadcast on the airwaves. R&O at 9-13. As demonstrated below, promotion of diversity of viewpoints has never been sufficient, standing alone, to justify intrusive broadcast ownership restrictions of sort at issue here. Moreover, even if promoting viewpoint diversity were a constitutionally sufficient basis for government control of broadcast ownership, the ownership limitations must be narrowly tailored to achieve viewpoint diversity. That showing has not and cannot be made.

A. In The Absence Of Functional Scarcity In the Video Programming Market, The Commission May Not Justify Ownership Restrictions On The Ground That They Will Increase Viewpoint Diversity.

The Report & Order makes repeated reference to the longstanding purpose of the multiple ownership rules "to encourage diversity in the ownership of broadcast stations so as to foster a diversity viewpoints in the material presented over the airwaves." R&O at 9. While it is true that increasing the diversity of viewpoints available on the airwaves has been used to justify ownership regulations, see, e.g., National Citizens Committee for Broadcasting v. FCC, 436 U.S. 775 (1978), it has always been tied to a showing that there is scarcity in the number of channels for the distribution of video programming. No case has sustained intrusive broadcast ownership restrictions absent the recognition that there is scarcity in the number of available video programming alternatives.

The significance of scarcity in the broadcast spectrum was first fully articulated in Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969). In Red Lion the Supreme Court upheld the constitutionality of the Commission's "fairness doctrine," pursuant to which broadcasters were required to present a balanced discussion of matters of public concern. 395 U.S. at 369. The Court focused on the scarcity of broadcast frequencies, finding that

> Where there are substantially more individuals who want to broadcast than there are frequencies to allocate, it is idle to posit an unbridgeable First Amendment right to broadcast comparable to the right of every individual to speak, write, or publish.

Following the Court's decision in Red Lion, the Supreme Court has considered the validity of several of the Commission's rules restricting the ownership of broadcast stations. And, in each of those cases, the perceived scarcity of the medium at issue was key to the analysis of the government's interest in promoting viewpoint diversity on the airwaves. See FCC v. NCCB, 436 U.S. at 799 (upholding the newspaper/television cross-ownership rule and observing that "[t]he physical limitations of the broadcast spectrum are well known" and that "Government allocation and regulation of broadcast frequencies are essential [and no one] here questions the need for such allocation and regulation"); Metro Broadcasting, Inc. v. FCC, 497 U.S. 547 (1990) (upholding minority ownership preferences and noting that the Court has "long recognized that because of the scarcity of electromagnetic frequencies, the Government is permitted to put restraints on licensees in favor of others whose views should be expressed on this unique medium" (internal quotations marks and citations omitted); United States v. Stover Broadcasting, 351 U.S. 192 (1956) (upholding a rule restricting television ownership and noting its validity in the context of the Commission's goal of avoiding excessive concentration of control in broadcast facilities).

The link between scarcity and diversity -- especially with respect to ownership restrictions -- makes sense. Government intervention to ensure viewpoint diversity is simply not needed or constitutionally sound when there is no functional limitation on the ability of interested speakers to present their views to the public. For example, it is inconceivable to us that the government could constitutionally intervene in the book publishing market and prescribe which publishing houses could publish certain types of literature or market books in particular geographic locations. The Supreme Court's willingness to tolerate just this sort of intervention in the broadcast market is directly tied to the assumption that video programming outlets are scarce, and that in the absence of such invention this scarcity will lead to a paucity of viewpoints being presented to the public. Indeed, there is significant doubt whether the Court would permit stringent ownership limitations on broadcasting if the scarcity assumption is no longer valid.

B. There Is No Functional Scarcity In the Market For Video Programming.

The Supreme Court has also recognized for many years that the scarcity that once existed in broadcast could well be overtaken by subsequent technological developments. "[T]he broadcast industry is dynamic in terms of technological development; solutions adequate a decade ago are not necessarily so now, and those acceptable today may well be outmoded 10 years hence." Columbia Broad. Sys., Inc. v. Democratic Nat'l Committee, 412 U.S. 94, 102 (1973). Thus, the Supreme Court has expressly stated its willingness to reconsider the Red Lion standard upon "some signal from Congress or the FCC that technological developments have advanced so far that some revision of the system of broadcast regulation may be required." FCC v. League of Women Voters, 468 U.S. 364, 376-77 n.11 (1984). Several courts have concluded that these developments have already occurred and that concerns about limited access to the airwaves no longer justify intrusive broadcast regulation. See Arkansas AFL-CIO v. FCC, 11 F.3d 1430, 1443 (8th Cir. 1993) (Arnold, J., concurring) (developments since Red Lion "raise a significant possibility that the First Amendment balance struck in Red Lion would look different today"); Syracuse Peace Council v. FCC, 867 F.2d 654, 681 (D.C. Cir. 1989) (Starr, J., concurring) ("[U]nder the Red Lion framework . . . the constitutionality of the fairness doctrine is linked in part to technological developments (and behavior) in the communications marketplace."); Branch v. FCC, 824 F.2d 37, 50 (D.C. Cir. 1987) (concluding that the FCC has already sent the "signal" mentioned in FCC v. League of Women Voters by deciding that the fairness doctrine was unconstitutional and should be abandoned); News America Publ'g, Inc. v. FCC, 844 F.2d 800 (D.C. Cir. 1988).

The Report & Order and numerous other decisions of the Commission irrefutably show that the factual underpinnings of the scarcity rationale for regulation have been undermined by dramatic changes in the media marketplace. In the Report & Order, the Commission recognizes that it has taken steps to increase competition and the range of choices for consumers by increasing the number of licensed broadcast stations and facilitating the development of alternative technologies such as cable television, direct broadcast satellite, multichannel multipoint distribution service and open video systems. R&O ¶¶ 28-29.

This is simply the most recent example of the Commission's recognition of the revolution the video distribution markets. In the mid 1980s, the Commission reconsidered the constitutionality of the fairness doctrine, the Commission's ultimate attempt to ensure viewpoint diversity in programming. In response to a directive from the D.C. Circuit, the Commission issued an order that expressly found the fairness doctrine unconstitutional based on the "explosive growth in the number and types of information sources available in the marketplace" such that "the public has 'access to a multitude of viewpoints without the need or danger of regulatory intervention.'" Syracuse Peace Council, 2 FCC Rcd. 5043, ¶¶ 4, 64 (1987) (quoting Inquiry Into Section 73.1910 of the Commission's Rules and Regulations Concerning Alternatives to the General Fairness Doctrine Obligations of Broadcast Licensees, 102 F.C.C.2d 142, 224 (1985)). The Commission concluded that "[t]o the extent that the [Supreme] Court is concerned about numerical scarcity in [broadcasting], . . . with the explosive growth in the number of electronic media outlets in the 18 years since Red Lion, there is no longer a basis for this concern." Syracuse Peace Council, ¶ 37 n.106.

At approximately the same time, the Commission eliminated several policies and rules regarding programming and license renewal processing, including a policy requiring full

Commission review of any television station renewal that reflected "less than five percent local programming, five percent informational programming (news and public affairs) or ten percent total non-entertainment programming." Revision of Programming and Commercialization Policies, Ascertainment Requirements, and Program Log Requirements for Commercial Television Stations, Report and Order, 98 F.C.C. 2d 1076, ¶ 5 (1984) ("Television Deregulation Order"). The Commission found that market forces would stimulate the desired mix of informational, local and non-entertainment programming without regulatory intervention, in part because

> Many new video technologies such as subscription Television (STV), Multipoint Distribution Service (MDS), Satellite Master Antenna Television (SMATV), Low Power Television (LPTV), Direct Broadcast Satellite (DBS), Multi-Channel MDS (MMDS) and Instructional Television Fixed Service Stations (ITFS) have begun, or are just beginning, to assert themselves in the marketplace . . . . The emergence of these new technologies, coupled with the continued growth in the number of television stations, will create an economic environment that is even more competitive than the existing marketplace. Given the market-based demand for these types of programming . . . this increased level of competition can, in our view, only further ensure the presentation of sufficient amounts of such programming.

Id. at 1086, ¶¶ 20-21.

In 1994 and 1995, the Commission repealed its financial interest and syndication ("fin/syn") rules as well as its prime time access rule ("PTAR"). These rules were similarly designed to protect competition and the marketplace of ideas by placing broad constraints on the financing, ownership and programming practices of the television networks. The Commission reconsidered these rules and determined that, given competitive conditions in the television marketplace, they should be repealed in their entirety. See PTAR Report and Order, 11 FCC Rcd. 546 (1995); Evaluation of the Syndication and Financial Interest Rules, 8 FCC Rcd. 3282, ¶¶

1, 3 (1993) ("Fin/Syn Second R&O"). In so doing, the Commission recognized the dramatic changes in the marketplace since their adoption, including the fact that network audience share had declined greatly, cable and independent television had grown significantly, competition among the three established networks and the Fox network had become intense, and first-run distribution had become a fully comparable alternative to network distribution for program producers. PTAR Report and Order, 11 FCC Rcd ¶ 21. The increased competition facing the networks and the new conditions in the television programming market eliminated the danger that repeal of the fin/syn rules or PTAR would impair the competition and diversity goals of these rules. Id. ¶¶ 3, 20; Fin/Syn Second R&O, ¶ 12.

This abbreviated recitation of the Commission's own frequent statements regarding scarcity reinforces the obvious: we live in a time of video overload. The notion that access to video programming options is limited in any meaningful way is simply fanciful. As a consequence, regulations such as the Commission's television ownership restrictions -- designed to solve an informational problem caused by scarcity -- are no longer constitutionally permissible.

C. Assuming, Arguendo, That Increasing Viewpoint Diversity Is An Important Government Interest, The Commission's Ownership Rules Would Be Subject To Intermediate Scrutiny.

As discussed above, the Commission may not constitutionally justify its intrusive ownership regulations solely on the ground that they will enhance viewpoint diversity. But, even if this were a proper basis for federal regulation of television ownership, the Commission's rules would be subject to intermediate scrutiny. As an initial matter, the Commission itself acknowledges that its ownership restrictions, if found to be content neutral, "will be sustained under the First Amendment if [they] advance[] important governmental interests unrelated to the suppression of free speech and does not burden substantially more speech than is necessary to further those interests." R&O ¶ 24 n.49.

This is clearly correct. Two court of appeals decisions involving challenges to section 533(b) of the Cable Franchise Policy and Communications Act of 1984, which made it unlawful for a telephone company to provide video programming in its telephone service area, applied intermediate scrutiny and held that the statutory prohibition on cross-ownership of a telephone and a cable company violated the First Amendment. These cases demonstrate that the federal courts will henceforth demand a close nexus between any ownership rule and the purported interest to be served. See US West, Inc. v. United States, 48 F.3d 1092 (9th Cir. 1994); Chesapeake & Potomac Tel. Co. v. United States, 42 F.3d 181 (4th Cir. 1994).

Applying intermediate scrutiny, the Ninth Circuit concluded that the cross-ownership ban was unconstitutional because there was insufficient evidence to demonstrate that the ban would foster competition in the cable industry or promote diversity in programming, and that less restrictive means of achieving diversity were available. US West, Inc., 48 F.3d at 1101-1106. The Fourth Circuit reached similar conclusions. In Chesapeake & Potomac, 42 F.3d at 198-203, the court observed, after looking at the history of Section 553(b), that "the FCC's reasoning does not indicate that attention was devoted to the possibility of other, less drastic regulatory schemes that might achieve the substantial government interests enunciated above." As these cases illustrate, once the scarcity rationale is eliminated, the Rule must be based on substantial evidence that the particular restriction will promote a significant government interest without suppressing substantially more speech than is necessary.[4] As demonstrated in the next section, the Commission's new duopoly rule cannot withstand intermediate scrutiny.

V. THE TELEVISION DUOPOLY RULE'S EXCLUSIVE FOCUS ON OWNERSHIP DIVERSITY IS NOT NARROWLY TAILORED TO SERVE AN IMPORTANT GOVERNMENTAL INTEREST.

The Commission's decision to permit duopolies only in those markets where 8 independently owned television stations would still remain following the combination exalts form over substance in smaller markets by elevating ownership diversity over any other diversity objective identified by the Commission. In particular, the Commission's decision ignores its own recognition that ownership diversity is not an end in itself but is instead only an indirect tool designed to enhance diversity of viewpoints in programming. By focusing exclusively on ownership diversity, the Commission ignored substantial evidence submitted by Pegasus and other commentors demonstrating that several economic factors combined to stifle the level of broadcast

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[4] These cases also serve as further evidence that the goal of achieving diversity, standing alone, is not sufficient to justify broadcast restrictions absent a demonstration of scarcity in the relevant market. See Turner Broadcasting Systems, Inc. v. FCC, 512 U.S. 622 (1994) ("The justification for our distinct approach to broadcast regulation rests upon the unique physical limitations of the broadcast spectrum"). In US West, the Ninth Circuit noted that the diversity rationale, which supported the Supreme Court's holding in Red Lion, was accompanied there by a finding of scarcity in the industry. It was the limitations inherent in the broadcast industry that supported ownership restrictions, with the achievement of an increase in diversity of viewpoints an appropriate secondary goal. Without a corresponding finding of scarcity in the cable industry, however, the restrictions at issue in US West could not withstand constitutional scrutiny based solely on the governmental interest in increased diversity. See also Chesapeake & Potomac Telephone Co., 42 F.3d at 181 (recognizing the significant governmental interest in promoting diversity of viewpoints while finding that alone insufficient to justify restrictions on free speech). Furthermore, in the above examples, the Commission used the existence of some perceived economic barrier to entry in the market as support of their goal of promoting diversity of viewpoints. As the Commission was unsuccessful in sustaining the rule in question in these cases, however, clearly the Commission would be unable to defend their decision to regulate merely to promote diversity absent a showing of some additional concrete economic harm it seeks to avoid.

programming diversity available in smaller markets, economic factors that will not be eliminated or overcome by the Commission 's new duopoly waiver policies. For these reasons, the Commission's duopoly rule will not survive intermediate scrutiny.

A. The Commission's Proper Focus is Programming Diversity Not Simply Ownership Diversity.

The Commission itself has consistently recognized that all of its broadcast ownership rules are indirect, structural measures aimed at "ensuring diversity of viewpoints in the material presented over the airwaves." Review of the Commission's Regulations Governing Television Broadcasting, Further Notice of Proposed Rulemaking, ("Television Further Notice") 10 FCC Rcd. 3524 ¶ 57 (1995). While the Commission may have recognized other diversity concepts, such as ownership and source diversity that it believed would lead to enhanced programming diversity, these other diversity concepts are only subsidiary tools designed to create or enhance the ultimate goal of programming diversity.

The Commission undertook an extensive review of the history of its diversity policies in the Television Further Notice. The Commission observed that it had used both direct and indirect methods to ensure diversity. The direct method involved regulations and policies specifically designed to encourage the provision of certain types of programming to the public. Id. ¶ 58.[5] The Commission noted that its indirect method used structural rules, including its broadcast ownership rules "limiting the number of stations that a person can own on both the national and local levels and those limiting the ownership interests that broadcasters may have in other media."

[5] Ironically, in a conclusion that Pegasus submits is entirely appropriate for the outcome of this proceeding, the Commission noted that the direct technique for regulating viewpoint diversity had "fallen out of favor" due to "changes in the marketplace -- chiefly the large increase in the number of broadcast stations and in competition with broadcasting -- and to heightened concern over First Amendment issues." Id. ¶ 59.

Id. ¶ 60. These structural rules, the Commission observed, "are intended to assure that information is dispensed from 'diverse and antagonistic sources.'" Id. (quoting Associated Press v. United States, 326 U.S. 1, 20 (1945)).

The Commission then confirmed that its indirect attempt to ensure viewpoint diversity led the Commission to promote two other kinds of diversity, outlet (i.e., ownership diversity) and source diversity, that the Commission regarded as important to ensuring "the ultimate goal of providing the public with a variety of viewpoints." Id. ¶ 61. Importantly, the Commission also acknowledged in the Television Further Notice that it was possible to maintain or enhance programming diversity without satisfying the ancillary objective of ownership diversity: "there is information to suggest that it may be possible to have a decrease in outlet [ownership] diversity without a corresponding decrease in viewpoint diversity." Id. ¶ 62.[6]

The Commission has recognized that ownership diversity is only an ancillary objective designed to enhance programming diversity in other contexts as well. In liberalizing its one-to-a-market rule waiver policy, the Commission noted that its broadcast ownership rules limited the number of outlets any single entity or individual could own "so as to foster viewpoint diversity." Amendment of Section 73.3555 of the Commission's Rules, the Broadcast Multiple Ownership Rules, Second Report and Order, 4 FCC Rcd. 1741, ¶ 16 (1989). It then confirmed "that diversity of ownership [i.e. outlet diversity] per se is not an end in itself. Rather the Commission

[6] Then-Chairman Hundt reiterated this conclusion in a speech presented to the American Bar Association: "Structural rules promoting outlet and source diversity, however, do not necessarily give us either voice or program diversity." 1996 FCC Lexis 1504, 3. Chairman Hundt went on to acknowledge that two of the Commission's rules designed to promote source and outlet diversity, the fin/syn and Prime Time Access rules, "were at best not working, and at worst were actually counterproductive" to the Commission's ultimate objective of promoting program or viewpoint diversity. Id.

has encouraged diversity of ownership simply as a means to achieve the public interest goal of promoting diversity of viewpoints [in programming]." Id. ¶ 16.[7] Similarly, in an earlier notice proposing to modify the so-called "seven station rule" that limited the number of AM, FM or TV stations a single entity could own nationally, the Commission similarly acknowledged that "[a]n issue which is fundamental to the Commission's consideration of diversity is the relationship between diversity of ownership and diversity of viewpoint . . . [w]hile all rules limiting ownership tend to increase the total number of owners, such rules do not necessarily guarantee greater diversity of program content or advance the welfare of individual viewers." Amendment of Sections 73.35, 73.240, and 73.636 of the Commission's Rules Relating to Multiple Ownership of AM, FM and Television Broadcast Stations, Notice of Proposed Rule Making, 95 F.C.C.2d 360, ¶ 58 (1983) (internal quotation marks omitted).[8] Unfortunately, as demonstrated below, the Commission failed to heed these observations and consider the impact of rigidly insisting on its 8 separate voices rule on the programming received by the public in smaller markets where several economic factors have combined to stifle competitive entry by new over-the-air stations.

[7] In adopting a liberalized waiver policy, the Commission recognized that a decrease in ownership diversity could actually enhance local news and public affairs programming diversity: "the joint ownership of two or more media outlets in the same market does not necessarily lead to a commonality of viewpoints by those outlets. . . . we conclude that relaxing the cross-ownership rule should not significantly affect diversity of viewpoints and should further programming and other public interest goals." Id. 1744, ¶ 18.

[8] The Commission observed that before it could determine if greater programming diversity resulted from promoting ownership diversity, an "examination of the costs which the rules impose" must be performed. Id. at 394. As detailed more fully below, the costs imposed by the Rule and its waiver policy have stifled the development of enhanced programming diversity, especially the development of new and/or enhanced local television news programming.

B. The Commission Has No Evidentiary Support For The Proposition That Different Owners Will Increase Programming Diversity.

The Commission claims that the amended television duopoly rule will promote viewpoint diversity. Other than the Commission's bare assertion, there is virtually no support for this proposition in the record or, for that matter, anywhere. The Report & Order states in relevant part:

> Some question whether diverse outlets and sources lead to diverse viewpoints, or whether our rules are necessary to promote diversity, suggesting that commonly owned outlets can produce diverse viewpoints equally well as separately owned outlets. We disagree with these arguments. As the Commission stated when it adopted the newspaper/broadcast cross-ownership rule, . . . it is unrealistic to expect true diversity from a commonly-owned newspaper combination. The diversity of their viewpoints cannot be expected to be the same as if they were antagonistically run. . . . Although the issue is not easily susceptible to empirical proof, we think intuitive logic and common sense support out belief that the identity and viewpoint of a station's owner can in fact influence the station's programming.

R&O ¶ 22 (internal citations and footnotes omitted). The Report & Order goes on to reference two studies supposedly supporting the proposition that ownership diversity will lead to diverse viewpoints being presented on the airwaves. <u>See</u> R&O ¶ 22 n. 46, citing Jeff Dubin & Matthew Spitzer, *Testing Minority Preferences in Broadcasting*, 68 S. Cal. L. Rev. 841 (May 1995); Congressional Research Service, *Minority Broadcast Station Ownership and Broadcast Programming: Is There A Nexus* (June 1988). The R&O then notes that, in the context of the newspaper/television cross-ownership rule, the Supreme Court found that the Commission had "acted rationally" in adopting the ownership ban. R&O ¶ 23, citing <u>FCC v. NCCB</u>, 436 U.S. at 801.

This meager showing is completely inadequate to demonstrate that the television duopoly rule is narrowly tailored to further an important governmental interest. First, and most significantly, the Commission has no empirical factual support for its assertion that more and different owners will lead to greater diversity of viewpoint (particularly editorial viewpoint) on the airwaves. The two studies referenced in the report and order do not in any way consider whether, as a general matter, different owners will lead to greater diversity of viewpoints being presented on the airwaves. Both studies (which rely on the same underlying data) consider the effect of the ethnicity and sex of owners on programming content. Dubin, 68 S. Cal. L. Rev. at 841. Nothing in either study supports the much broader argument that merely having different owners will lead to the presentation of diverse editorial viewpoints.

This complete lack of factual support is alone fatal to the rule. To satisfy intermediate scrutiny, a rule must "further[] an important or substantial governmental interest" that is "unrelated to the suppression of free expression" and the "incidental restriction on alleged First Amendment freedoms is no greater than is essential to the furtherance of that interest." U.S. v. O'Brien, 391 U.S. 367, 377 (1968). See also Turner I, 114 S. Ct. at 2469; Ward v. Rock Against Racism, 491 U.S. 781 (1989). Mere statements or assertions unsupported by a substantial factual record are insufficient to sustain a rule which burdens First Amendment rights. As the Supreme Court explained in Turner I:

> When the Government defends a regulation on speech as a means to redress past harms or prevent anticipated harms, it must do more than simply posit the existence of the disease sought to be cured. It must demonstrate that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in direct and material way.

Turner I, 114 S. Ct. at 2470.

The inadequacy of the R&O's factual record is reinforced by the decision of the D.C. Circuit in Lamprecht v. FCC, 958 F.2d 382 (D.C. Cir. 1992). In Lamprecht, the D.C. Circuit applied intermediate scrutiny to strike down a Commission policy of giving preferences to women in its comparative licensing program. The Commission had justified that preference on the ground that women would tend to air more women's programming, and would thus contribute to diversity of viewpoints. Id. at 391. The D.C. Circuit, in finding the preference unconstitutional, noted that the Supreme Court requires that generalizations about programming content "be supported [and] that the support be strong enough to advance substantially the legitimating government interest." Id. at 175 (internal citations omitted). Any "predictive judgments concerning group behavior and the differences in behavior among different groups must at the very least be sustained by meaningful evidence." Id. at 393 (internal quotation marks omitted). The court found the rule unsupported because, *inter alia*, the Commission could cite "nothing that might support its predictive judgment that women owners will broadcast women's or minority or any other under represented type of programming at any different rate than will men." Id. at 395. The court reached this conclusion notwithstanding evidence that arguably demonstrated that minority owners tend to broadcast more minority oriented programming. Id. at 397-98.[9] As demonstrated in the next section, the FCC had no basis to conclude that insisting on 8 separate television owners in smaller markets would produce more diverse programming.

C. The New Duopoly Rule Will Inhibit Rather than Enhance Programming Diversity in Smaller Markets.

In adopting an 8 separate television voices rule regardless of market size, the Commission clearly ignored marketplace realities -- realities that will effectively prevent the entry of over-the-

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[9] The Commission's reference to FCC v. NCCB, 456 U.S. at 802, is unavailing. If anything, that decision reinforces the conclusion that the record in support of the rule is inadequate. In NCCB, the Court applied the extremely low level of scrutiny approved in Red Lion and upheld the Commission's newspaper/broadcast cross-ownership rules. In so doing, the Court merely found that the ownership restrictions were not "unreasonable" and called the Commission's judgment "rational." Id. This decision in no way shows that the television duopoly rule could survive the much more searching inquiry required by intermediate scrutiny.

television stations in smaller markets. Because the Commission failed to address these economic realities in small markets or explain how its continued, rigid insistence on maintaining ownership diversity will further its overall diversity objectives, the new duopoly rule will not survive intermediate scrutiny.

1. Marketplace Realities: Pegasus submitted extensive evidence in response to the Second FNPRM demonstrating that today's marketplace realities inhibit new, over-the-air station entry in smaller markets. A combination of economic factors, including the costs of new station construction, the presence of several entrenched, often VHF, over-the-air competitors, relatively low overall market revenues, and competition from cable and other multichannel video providers ("MVPDs"), effectively stifle market entry by new, stand alone over-the-air stations. As a result, Pegasus argued that there could be little wonder that smaller markets today are characterized by high concentration and very little over-the-air programming diversity.

In its earlier comments, Pegasus illustrated that prospective new entrants to smaller markets faced a series of significant economic barriers to entry. First, Pegasus focused on the costs of new station construction. Pegasus estimated that the costs of construction for a truly competitive, stand-alone, full-service commercial broadcast station typically required an expenditure of approximately \$2-\$5 million, with an additional \$1 to \$2 million added if a local news operation was planned. While Pegasus recognized that these costs could vary somewhat, depending for example on whether a new tower needed to be constructed, it demonstrated that these start-up costs were relatively inelastic despite a reduction in market size. Pegasus also highlighted how the Commission's truncated DTV build-out schedule added several million more in DTV facility construction costs to a new station's projected start-up costs.

Despite these relatively inelastic start-up costs, Pegasus illustrated that the overall level of market revenue declined much more quickly as market size declined. While the total 1995 television market revenues ranged from $1.3 million to $348 billion in markets 1 through 10, these figures ranged from $86 million to $45 million in markets 50 through 60 and $36 million to $26 million in markets 90 to 100. Pegasus went on to demonstrate that these two factors combined to create a significant entry barrier in smaller markets -- while the overall market revenue level decreased as the size of the market dropped, the minimum annual revenue needed to cover operating and borrowing costs and provide a sufficient return for investors in the start-up station did not decline nearly as fast.

Pegasus estimated that a new, stand-alone station required annual revenues of approximately $3-4 million to cover its fixed costs and generate operating income sufficient to amortize the cost of construction. Pegasus demonstrated that while this annual revenue requirement for a start-up station posed very little problem in large markets like New York City, where a television station could be profitably operated with less than 1% of the estimated 1995 total television market revenue, it represented approximately 10% to 12.5% of the total television market revenue in Jackson, Mississippi (DMA No. 91) and could require as much as 20% to 25% in smaller markets. Thus as market size dropped, the percentage of market revenue that a new, start-up station needed to be successful grew significantly.

The new entry problems did not end there, however. Pegasus also demonstrated that achieving these revenue levels was also extremely difficult given the very high levels of concentration in smaller markets. While the number of stations in markets 1-10 averaged slightly more than 13 and the combined share of the top-3 stations in those markets equaled 63%, the number of stations declined to an average of 5.8 in markets 51-100 and the combined share of the top-3 stations in the market rose to 86.2%. Pegasus demonstrated that the concentration in these smaller markets was due to the presence of a number of entrenched, typically VHF stations that had historically affiliated with either ABC, CBS or NBC and had captured very large shares of the television revenue in the market.[10]

The growth and success of cable television and its multiple channel offerings have exacerbated the barriers to entry faced by new, over-the-air entrants. Whereas through the 1970s, viewers had very few alternatives to over-the-air stations, these choices have exploded in the past two decades. As a result, contrary to the Commission's apparent assumption, the control of a new, over-the-air television license does not simply allow its holder to attract viewers and make money. Instead, it is not at all uncommon for start-up licensees, regardless of market size, to earn a smaller audience share than many cable networks and/or to experience severe financial problems or end up in bankruptcy proceedings. In addition, a number of allocations, especially in smaller markets, remain unbuilt or vacant.

The competition from MVPDs is even more pronounced in smaller markets. Cable penetration in smaller markets is typically higher than in larger markets as viewers respond to the increased variety that these MVPDs offer. Moreover, the programming offerings of MVPDs, most particularly cable systems, have increasingly siphoned audience share (and advertising revenue) away from over-the air stations. In Pegasus's markets, cable programming regularly accounts for between 35% to 45% of the total household viewing in the market. This decline in

[10] Pegasus highlighted how the strength of these well-established stations could be traced at least in part to the FCC's television allocation policies that focused originally on VHF allotments in the early 1950s and then later filled in with UHF allocations. As a result, these well established VHF stations typically accounted for an overwhelming percentage of market revenues.

ratings exacerbates the already significant problems faced by a new over-the-air entrant in smaller markets.

The dual revenue stream of the cable industry has also impacted the ability of over-the-air stations to compete as network affiliates. In the past few years, competition from basic cable programmers has driven the costs of over-the-air network programming significantly higher. These increased programming costs have created a crisis in the relationships between networks and their affiliates. Several major networks, including ABC and Fox, have sought to or successfully taken back advertising avails (or the proceeds earned from their sale) previously controlled by the affiliates to help offset these costs. The networks that have previously made compensation payments to affiliates are trying to reduce or eliminate them and each network has attempted to limit the programming exclusivity they provide to their affiliates, thereby opening a second revenue stream typically through cable exhibition. These developments have only further served to reduce the ability of local stations to compete by increasing the costs they must pay for programming. These increasing costs of programming only make new, stand alone entry even harder to justify.

This combination of factors in smaller markets -- (i) limited overall market revenues, (ii) high required revenue share to cover relatively inelastic start-up costs and operating expenses, (iii) significant competition from well-established over-the-air and MVPD providers and cable programmers -- make it almost impossible to justify a new, standalone over-the-air entry.

2. Economic Solutions: Pegasus illustrated, however, that LMAs and/or duopolies dramatically altered the underlying economics and permitted new entrants to overcome these severe economic barriers. In particular, Pegasus estimated that combining a new station with an already existing station reduced the required start-up costs by as much as 67%, reduced the fixed operating costs of the new station by as much as 67% and permitted the two stations to share and amortize the start-up costs of local news production facilities. These start-up costs savings included the sharing of a single studio, production facilities, master control and other fixed, physical plant costs as well as the possibility of sharing a single antenna on a single tower. These savings, combined with reduced personnel costs, dramatically reduced the revenue level needed to justify new entry in these markets.

Based on this showing, Pegasus urged the Commission to avoid the overly simplistic, but oft-repeated incantation that smaller markets present the greatest risk to the Commission's diversity and economic goals. Pegasus instead argued that the Commission needed to focus on these economic factors as it reviewed the duopoly rule. Pegasus demonstrated that duopolies and/or LMAs were, in fact, economically essential if the Commission were seriously interested in furthering its underlying diversity and economic goals in smaller markets.

Pegasus itself has followed this model to support the start-up of new television stations in several of its markets. For example, Pegasus helped fund the construction and launch of WPME-TV in Lewiston, Maine, the new UPN affiliate in the Portland DMA (Market No. 80). Prior to the involvement of Pegasus, the construction permit for what is now WPME-TV had been unbuilt for a number of years. In this as well as its other markets, the economies of scale offered by an LMA permitted Pegasus to make the substantial economic investment needed to help add a new station to the market. In Portland, the enhanced economic support also enabled Pegasus to upgrade significantly its local news offerings in the DMA. These new stations have materially enhanced the over-the-air programming diversity in their respective markets and increased the choices available for local advertisers. Of equal importance, these increased choices are available to all television viewers in the market, not simply those who can afford to pay for the increased variety available from cable and other MVPDs.

3. The Commission's Error: The Commission's decision to establish an overall duopoly threshold of 8 independent television voices, regardless of market size, ignored this substantial and unrefuted evidence about station entry in smaller markets. Instead, with a striking lack of reasoning or explanation, the Commission mechanically chose to exalt ownership diversity over all else by establishing a threshold that will never be achieved in smaller markets due to the combination of entry barriers identified by Pegasus. In so doing, the Commission forced viewers in smaller markets to continue to turn to cable and other MVPDs for any increases in programming diversity. Ironically, through authority to regulate that is historically derived from the notion of "scarcity" of broadcast channels, the Commission has acted to ensure scarcity in smaller markets by prohibiting precisely the type of ownership combinations needed to help add new stations to the market.

The Commission repeatedly attempted to justify its new duopoly rule based on the "continuing dominant role played by broadcasting in society" and the fact that "broadcast television remains the primary source of news and information for most Americans." Local Television R&O ¶¶ 40-41. Unfortunately, the Commission failed to recognize that new stations in small markets play no role, much less a dominant role, in these markets and do not have the economic resources to provide any local news or public affairs programing. As demonstrated in the record, the costs of a local news broadcast only exacerbate the entry barriers faced by a new station in a smaller market. By failing to face up to these economic realities, the Commission has essentially guaranteed that viewers will not receive any new local news and public affairs programming from start-up over-the-air stations in smaller markets.

One of the most striking portions of the Commission's new duopoly standard is its decision not to count any other providers of video programming toward its minimum voice requirement. This decision reflects the Commission's continued unwillingness to recognize the marketplace competition that these MVPDs provide to over-the-air broadcasters, competition that is especially significant in smaller markets. The Commission's refusal to do so is even more remarkable given the fact that it did include other media in the voice count it established for one-to-a-market waivers.[11] The unwillingness to recognize marketplace realities for over-the-air television stations and the Commission's refusal to recognize that ownership diversity is not an end unto itself combine to produce a completely unworkable duopoly standard in smaller markets.

The Commission's decision also violates the commands of the 1996 Act, which explicitly instructed the Commission to review all of its broadcast ownership rules every two years to "determine whether any of such rules are necessary in the public interest as the result of competition." Section 202(h) (emphasis added).[12] The evidence before the Commission clearly and unequivocally illustrated that competition in smaller markets made the duopoly rule counterproductive because it inhibited both diversity and competition in those markets.

In an apparent attempt to address this issue, the Commission adopted 3 waiver standards for failed, failing and unbuilt stations that it hoped would "provide relief in a more tailored fashion for stations in smaller markets that are unable to compete effectively." R&O ¶ 70. Unfortunately, these waiver criteria do not address the problems identified by Pegasus. First,

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[11] In particular, the Commission counted independently owned, English-language daily newspapers published in the DMA as well as cable systems (at least as 1 voice), provided cable was "generally available" in the television DMA. Local Television R&O, ¶ 111.

[12] While the Commission did not explicitly include the duopoly review in its first biennial review, it did so only because it was already conducting a review of the rule. Thus, the command of Section 202(h) still controls the Commission's decisionmaking in this proceeding.

they effectively amount only to rebuttable presumptions. The Commission clearly stated that while it will be predisposed to grant waivers meeting these criteria, it intends to entertain petitions to deny seeking to rebut the waiver requests. Id. ¶ 77.

Second, the waiver criteria are vague and do not provide market participants the level of certainty needed to justify the requisite level of investment and commitment to build a new station. In particular, the vague standards create the opportunity for opportunistic, post-hoc collateral attacks on a requested (or previously established) combination. Vagueness and uncertainty are inimical to capital markets. Given this uncertainty, local stations will almost by definition not get the full value of the combinations they create and virtually guarantees that small market entry will be restricted under these waiver standards.

For example, each waiver criterion requires a similar showing -- namely that the in-market buyer "is the only reasonably available entity willing and able to operate the station, and that selling to another buyer would lead to an artificially depressed price for the station." Id. ¶¶ 76, 81 & 86. This standard is vague. For example, what is an "artificially depressed" price? Any amount less than what the in-market station would pay or some specified percentage lower? In addition, what must an in-market station do to qualify as the only "reasonably available" candidate to buy the station? Does that station need to be the only one in the market willing to buy it or the one willing to pay the most for it? As these questions illustrate, and as the Commission has recognized in other circumstances, a waiver policy simply does not provide the level of certainty and guidance that participants in the marketplace need before committing the resources required in these circumstances. This uncertainty is exacerbated for publicly traded companies due to the corresponding disclosure obligations and related duties to their shareholders.

For owners like Pegasus, these vagueness problems are compounded by the fact that the Commission has effectively decided to apply these new standards retroactively by limiting grandfathering protection to LMAs entered into before November 5, 1996. Pegasus entered into LMAs, as it was clearly permitted to do under the Commission's rules, and made substantial investments in several markets that added new, over-the-air stations to those markets. As noted above, Pegasus entered into these relationships in circumstances that satisfied the Commission's proposed duopoly criteria, including the presumed rule for UHF combinations as well as the proposed waivers for new construction and when the combination produced enhanced public interest programming benefits. Unfortunately, Pegasus had no notice at the time it made these investments of the revised waiver standards the Commission would subsequently choose to apply in deciding whether to permit these pro-competitive and diversity-enhancing relationships to continue. In particular, Pegasus had no ability to generate the contemporaneous evidence at the time it entered into these relationships that the Commission only recently decided it would rely on in granting duopoly waivers under its new standards.

Third, and equally important, stations that are combined pursuant to one of these criteria can be transferred together only if the combination satisfies one of the same three vague waiver criteria at the time of transfer. This restriction compounds the problem noted above by failing to provide the requisite incentive for station owners to make the investment necessary to launch a second station in the market. Simply put, the inability to transfer a station will make it even harder to justify an initial investment in smaller markets that have limited overall revenues and significant levels of competition from both over-the-air and cable. In particular, this rule will again subject a station to opportunistic, post-hoc collateral attacks and will clearly punish success -- the possibility of which will only exacerbate the problems in capital markets.

As demonstrated above, by insisting on an overall threshold of 8 television voices before permitting duopolies, Pegasus submits that the Commission has undermined its very diversity goals by virtually assuring that no new, over-the-air television entry will occur in smaller markets. The Commission's decision to ignore these fundamental facts in smaller markets will not survive intermediate scrutiny because the rule is in no way tailored to serve its interest in over-the-air programming diversity in smaller markets.

VI. THE COMMISSION SHOULD ADJUST ITS DUOPOLY RULE TO REFLECT ECONOMIC REALITIES IN SMALLER MARKETS.

To correct these problems, Pegasus submits that the Commission should revise its duopoly rule in several important ways that recognize the economic realities in smaller markets. As discussed below, Pegasus submits that without such action, the Commission will abandon any realistic hope of improving over-the-air programming diversity available to viewers in these markets.

A. The Commission should permit duopolies in smaller markets whenever a second, separately programmed station is added to the market or rescued from bankruptcy.

Given the levels of competition and the significant barriers to new station entry discussed above, the Commission should adopt a presumptive duopoly rule in smaller markets that permits duopolies whenever a second, separately programmed station is added to the market or rescued from bankruptcy. Pegasus submits that such a rule is entirely justified by the economic factors discussed above, factors that have and will continue to stifle new over-the-air station entry in these markets. This rule would dramatically lower those entry barriers faced by new entrants in smaller markets and correspondingly reduce the revenue levels needed to support a new station by allowing them to share both costs and revenues with an existing station.

Moreover, the recommended rule will not result in an overall decline in ownership diversity, as a new station is by definition being added, but will increase programming diversity as well as providing a new outlet for producers of video programming. In fact, as the Commission itself recognized, the owner of two stations in a single market has every incentive to program its stations to attract entirely different audiences: "[u]nder this view, where there are competing parties [two separate owners], each their strategies would be to go after the median viewer with the 'greatest common denominator' programming, leaving minority interests unmet. But where one party owned all the stations in the market, its strategy would be to put on a sufficiently varied programming menu in each time slot to appeal to all substantial interests." Television Further Notice ¶ 63. The rule would also be consistent with the Commission's observations noted above that ownership diversity is not an end in itself but is instead a regulatory tool designed to enhance over-the-air programming diversity available in these markets.

The addition of a new source for over-the-air television programming in smaller markets should not be underestimated. Such a rule would encourage the creation of new outlets for the so-called start-up networks in smaller markets, markets that these networks have consistently been foreclosed from despite overall Commission policies that encourage the development of these networks. In addition, the proposed rule will provide the only realistic hope that new stations will ever be able to provide local news and public affairs programming. As noted by Pegasus, local news programming adds significantly to the costs of new station start-up, costs that can be more easily absorbed and amortized over two stations. Without such a rule, Pegasus submits that these new networks will increasingly be forced to expand their national distribution via cable and other MVPDs, thereby depriving over-the-air viewers in these smaller markets of the programming diversity enjoyed by viewers in the largest markets.

B. The Commission should allow small market duopolies to be transferred without additional waiver showings.

Pegasus also urges the Commission to allow duopolies in small markets to be transferrable without requiring the prospective new owner to satisfy any of the three waiver criteria. Pegasus urges the Commission to make this change regardless of whether it adopts the presumptive duopoly rule for smaller markets discussed above.

The importance of eliminating the limitation on transfers cannot be understated. The Commission itself recognized the many positive, public interest benefits that have been created by LMAs. These benefits include adding an entirely new station or significantly enhancing the programming carried on the second station. In certain circumstances, these benefits also include the investment in local news programming production facilities as the opportunity to amortize these start-up costs, estimated to be between $1 to $2 million, over two stations makes such an investment possible. In these instances, the combined operations require a serious and substantial commitment of time and resources -- a commitment that the Commission should do everything to encourage as it produces demonstrable and verifiable public interest benefits, especially in smaller markets where standalone new entry is almost impossible.

The Commission's proposal to subject previously approved duopolies to the same three waiver standards discourages these significant commitments. Pegasus has already identified the vagueness problems associated with the three proposed waiver criteria. See infra at 34-36. These amorphous waiver standards provide the perfect opportunity for competitively motivated challenges to proposed transfers. Moreover, as the success of the two stations increases, the likelihood that such a filing will occur will only increase. This uncertainty will cause capital markets to discount these arrangements accordingly, thereby reducing the availability of capital and the incentive of stations to invest in the markets.

Pegasus submits that any concerns about permitting powerful station combinations to be transferred will be properly addressed by the review under taken by the relevant antitrust agency. However, should the Commission decide not to rely on antitrust enforcement, Pegasus renews its earlier proposal that the Commission apply a combined market share test that limits presumptive transfers of duopolies if the combined market share of the two stations exceeds 40% or the market share of the number one station in the market, whichever is smaller. This market share test addresses any legitimate economic concerns without unduly punishing the investing station.

While the Commission's theoretical interest in preserving the opportunity to create two separately owned stations is understandable, Pegasus submits that the marketplace has already addressed this issue. Absent the support of an existing station, new station entry is virtually non-existent in smaller markets and the increasing level of over-the-air audience fragmentation to other MVPDs (to say nothing of the Internet and the increasing number of other viewer distractions) strongly suggests that those prospects will never improve. The ever-increasing tension between the networks and their affiliates is yet another example of the profound, irreversible competitive changes that have occurred in recent years, changes that have the most significant impact in smaller markets.

By their very nature, small markets do not present a very attractive target for investors or lenders. The limited size of overall market revenues and the competitive landscape described above are significant deterrents to serious financial commitments. Pegasus submits that the Commission should do its best to remove any regulatory obstacles to serious financial commitments in smaller markets. By permitting duopolies to be transferred, the Commission will ensure that its new rules do not punish success or discourage entrepreneurial, public interest commitments. The proposed market share test should assure the Commission that transfers will not be allowed in those instances where the two combined stations represent a significant economic factor in their market. Given the state of competition and diversity in smaller markets, Pegasus submits that this proposal is well worth the limited regulatory risk involved.

C. The Commission should expand or clarify those station relationships entitled to 5 year grandfathering.

To the extent the Commission does not change its LMA grandfathering decision, Pegasus submits that the Commission should expand or clarify the relationships between stations that are entitled to 5 year grandfathering. Specifically, Pegasus submits that stations with programming relationships more extensive than LMAs (e.g., satellite stations) that were in effect before November 5, 1996 should also be entitled to 5 year grandfathering if the satellite status between the stations was subsequently ended.

Pegasus owns and operates WOLF(TV), NTSC 56 (Fox), Hazleton, PA and programs WSWB(TV), NTSC 38, (WB), Scranton, PA pursuant to an LMA originally dated June 26, 1997. Pegasus formerly owned both stations (although they had different call signs) and operated what is now WOLF as a satellite of what is now WSWB. These two stations, along with a third station that was and remains a satellite station, operated on a satellite status since the late 1980s.[13]

After more than a year of filings and negotiations with the Commission staff, Pegasus ultimately received permission in 1997 to relocate the transmitter of what is now WOLF to the site used by other stations in the Wilkes Barre/Scranton market. Pegasus completed construction

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[13] Pegasus also owns and operates WILF(TV), Williamsport, PA as a satellite of what is now WOLF and will continue to do so.

of the new WOLF facility in 1998. This station upgrade permitted Pegasus to serve the market without the need for the market coverage provided by what is now WSWB. In anticipation of the WOLF upgrade, Pegasus sold what is now WSWB but continued to program it pursuant to the 1997 LMA. WSWB signed on as the new WB affiliate in the DMA in November 1998.

Pegasus submits that in these circumstances its LMA between WOLF and WSWB should be entitled to 5 year grandfathering because the programming relationship between these stations in effect as of November 5, 1996 was more extensive than a typical LMA. By definition, a satellite relationship is a more extensive programming relationship than an LMA because it involves complete duplication rather than simply separate program selection. Because this satellite relationship predated the November 5, 1996 cut-off date, it should be entitled to the same treatment as any LMA in effect as of that date. Pegasus submits that a contrary result would punish Pegasus for actions that were clearly in the public interest.

VII. CONCLUSION.

As demonstrated above, Pegasus submits that the time has come for the Commission to recognize the marketplace realities in smaller markets and abandon its one size fits all approach to regulating television ownership in those markets. In smaller markets, the Commission's new 8 independent television voices duopoly rule will not enhance its diversity policy. Instead, the rule will continue the status quo where new over-the-air station entry is non-existent and viewers are required to turn to cable for new video programming. To counteract these undeniable marketplace facts, Pegasus urges the Commission to encourage significant, long term investment in smaller markets by presumptively allowing any duopoly that adds a new, separately programmed station to the market or rescues one from bankruptcy. To provide the proper regulatory incentive for investment, Pegasus also strongly urges the Commission to permit duopolies in smaller markets to be transferrable without satisfying the new proposed waiver standards. To the extent the Commission is unwilling to rely on the antitrust enforcement agencies, Pegasus submits that the Commission should only limit presumptive duopoly transfers if the market share of the combined stations exceeds the smaller of (i) 40% or (ii) the market share of the number 1 station in the market.

Respectfully submitted,

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